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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1962

No. 1088

JOHN B. BAILEY,
Petitioner,

vs.

SANDELL, INC., a corporation,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the District Court of Appeal
of the State of California
Fifth Appellate District

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Petitioner prays that a Writ of Certiorari issue to review the judgment of the District Court of Appeal of the State of California, Fifth Appellate District, entered in the above case on February 13, 1963, which affirmed the judgment of the Superior Court of the State of California in and for the County of Fresno.

a court of general jurisdiction, and which Superior Court had entered judgment in favor of respondent after a trial on the merits in the sum of Fifty Thousand Dollars, plus Five Thousand Dollars attorneys' fees, plus interest;

That on February 28, 1963, petitioner filed a Petition for Rehearing in the said District Court of Appeal, and that thereafter and on March 11, 1963 said District Court of Appeal denied said Petition for Rehearing; that thereafter on March 26, 1963, petitioner filed his Petition in the Supreme Court of the State of California for a hearing on said matter, and that thereafter and on April 9, 1963, the said Supreme Court of California denied said Petition for a Hearing.

That said District Court of Appeal is an intermediate Court between the said Superior Court and said Supreme Court of California, and said District Court of Appeal had jurisdiction to hear said appeal above referred to.

OPINION BELOW

The judgment of the Superior Court of the State of California in and for the County of Fresno is not reported. The judgment of the District Court of Appeal of the State of California, Fifth Appellate District is reported in 212 ACA 935, and a copy of said opinion of the said District Court of Appeal is attached hereto (Appendix A).

That the opinion of the Supreme Court of the State of California denying petitioner's hearing is not reported but that a copy of the minute order is attached hereto (Appendix B).

JURISDICTION

The jurisdiction of this court is invoked pursuant to Title 28, Section 1257 of U.S.C.A., and Amendment XIV to the United States Constitution.

QUESTIONS PRESENTED

1. Whether a broker dealer licensed by the Securities and Exchange Commission of the United States can sell stock issued under an exemption from registration without obtaining a favorable ruling upon a proposed sale to the general public by the Securities and Exchange Commission of the United States; and

2. Whether a Court can rewrite an agreement by omitting material language intentionally inserted in the agreement by the parties.

FACTS

Petitioner is a stockbroker at all times licensed by the Securities and Exchange Commission. He was underwriter on an issue of stock in the Cleary Oil Corporation, a Canadian corporation, which stock was

sold pursuant to an exemption from the provisions of the Securities Act of 1933. The stock was sold under an Offering Circular dated November 18, 1954. The Cleary Oil Corporation was engaged in leasing oil properties in Canada, drilling on proven locations, and the sale of oil.

In March 1955, all of the shareholders of Cleary Oil Corporation, including petitioner, were given an opportunity to exercise preemptive rights to purchase additional shares of stock in the corporation at the rate of one for one. The president and sole owner of respondent was V. I. Sandell, and Sandell was also a shareholder included in the preemptive rights offering. Petitioner and Sandell were both directors of the corporation in March 1955. Petitioner was a substantial shareholder in the company, and was desirous of purchasing all of the shares to which he would be entitled under the preemptive rights offering, and to be able to do so, borrowed from respondent corporation $50,000.00, which loan is the subject of this action. The parties met in the office of petitioner on April 1, 1953 and together drew up a note as follows:

> "*$50,000.00* Fresno, Calif. *April 1, 1955* *Eight months and 19 days or as otherwise agreed* after date, without grace, for value received *I* promise to pay to *Sandell Inc.* or order, the sum of *Fifty thousand* - - - - - Dollars with interest thereon at the rate of *5 (five) percent* per *annum* from date until paid. Interest to be paid *on maturity* and if not so paid as it becomes dues, to bear interest at the same rate as said principal

sum, but if default is made in the payment of interest that the principal sum of this note shall immediately become due at the option of the holder thereof. If suit is brought to collect this note, I agree to pay any attorney's fee incurred for collection. All payments which become due are to be made in United States Lawful Money.

John B. Bailey

Address: 2133 Fresno Street
Fresno, California
2303 Fresno Street"

At the same time, the parties entered into an oral agreement which was reduced to writing by them on April 15, 1955. The agreement is as follows:

"April 15, 1955

The following is an agreement entered into between Sandell Inc. and John B. Bailey in consideration of a loan by the first party to the second party of $50,000, receipt of which is hereby acknowledged by second party.

As security for the aforesaid loan, John B. Bailey does hereby deposit with Victor I. Sandell, as Trustee, one certificate number 5, for 5,000 shares of Cleary Oil Company Limited, Capital Stock. Said loan will also be evidenced by a note in the amount of $50,000, bearing interest at the rate of 5%. Said note shall be due and payable on January 15, 1956, *or as soon thereafter as clearance is granted by the S.E.C.* for the sale by Party of the Second Part, of Cleary Oil Company Limited, Capital Stock shares, purchased under the offering circular, dated November 18, 1954. These shares are to be released to John B. Bailey upon the payment of $5,000 for each 500

shares held as security. *As consideration for this loan*, John B. Bailey does hereby grant to Victor I. Sandell, an option to purchase 1500 shares Cleary Oil Company Limited, Capital Stock at $10.50 per share, U.S. Funds. This option will become effective on November 19, 1955, or as soon thereafter as clearance is granted from the S.E.C. for John B. Bailey to transfer those shares from stock purchased under an offering circular, dated November 18, 1954.

In no event shall Victor I. Sandell, as Trustee, be required to return to John B. Bailey, the 1500 shares held by him for the exercise of his option until the option is exercised.

In the event Victor I. Sandell exercises his option before the note herein mentioned becomes due and payable, the purchase price of the stock shall be remitted by Party of the Second Part as payment upon said note.

/s/ John B. Bailey

Sandell Inc.
By: V. I. Sandell, Pres.
V. I. Sandell"

(Emphasis ours.)

On July 5, 1957, plaintiff filed suit against petitioner and the First Amended Complaint, on which the issues were joined, alleged that at no time had the Securities and Exchange Commission, known as the S.E.C., provided for the granting of a clearance, or required the granting of a clearance for the sale by petitioner of the shares mentioned in the agreement, and that the S.E.C. was and is without authority to and could not grant such a clearance and that

the same was not possible. Plaintiff further alleged that the note became due on January 15, 1956, which date was a reasonable time following the execution of the note for its maturity.

Petitioner in his answer denied the allegations of the complaint as set forth, and affirmatively alleged that the S.E.C. did have power and authority at all times to grant a clearance. Petitioner further denied that the note in question became due on January 15, 1956, or that it became due at all. Petitioner admitted that he made no cash payment upon the note, but alleged that the option granted to V. I. Sandell, plaintiff's alter ego, for the purchase of 1500 shares at the price of $10.50 per share under the written agreement was of a fair market value at the time it was granted of not less than $50,000.00. As a special defense, petitioner pleaded that clearance is a condition precedent to liability on the note, and that the same was a material part of the contract, which had not been fulfilled.

The trial court found that the note was due ninety days after January 15, 1956, and that the purpose of inserting the provision for clearance was to enable petitioner to become assured that he could safely sell the shares of stock mentioned in the agreement. Judgment was rendered for the full amount plus attorney's fees.

I

WHETHER A BROKER DEALER LICENSED BY THE SECURITIES AND EXCHANGE COMMISSION OF THE UNITED STATES CAN SELL STOCK ISSUED UNDER AN EXEMPTION FROM REGISTRATION WITHOUT OBTAINING A FAVORABLE RULING UPON A PROPOSED SALE TO THE GENERAL PUBLIC BY THE SECURITIES AND EXCHANGE COMMISSION (WITHOUT VIOLATING THE PROVISIONS OF 15 U.S.C.A. 77e).

The trial court found (Finding 5) that the parties intended that the provision for granting of clearance was to enable petitioner to have a reasonable time to assure himself that he could safely sell the stock purchased by him under the Offering Circular of November 18, 1954, without being in violation of the regulations of the Securities and Exchange Commission; and (Finding 6) that a reasonable time for obtaining such clearance was ninety days after January 15, 1956.

Suit was filed on July 7, 1957.

The District Court of Appeal variously found (Appendix A) that clearance did not exist, and if it did, that petitioner would not need it. To make such a conclusion, the District Court must have found that there was no restriction of any kind, nor any possible restriction upon the sale by appellant of the shares purchased under the Offering Circular of November 18, 1954. The confusion of the District Court of Appeal on this issue appears to be a basic misunderstanding of the definition of the term "underwriter". In addition to the fact that petitioner was the underwriter of the stock sold under the November 18, 1954 offering circular, petitioner may also be an under-

writer under the Securities Act of 1933 (15 U.S.C.A. 77). It is uncontradicted that petitioner purchased stock under the November 18, 1954 offering circular.

15 U.S.C.A. 77e reads as follows:

"5. 77e

(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

1. to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

2. to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security, for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

1. to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 77j of this title; or

2. to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection a of 77j of this title.

(c) It shall be unlawful for any person directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title."

Certain transactions are exempted under 15 U.S.C.A. 77 d (1):

"4 *77d* Exempted transactions.

The provisions of section 77e of this title shall not apply to any of the following transactions:

(1) Transactions by any person *other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering;* or transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction) except transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter, and transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the

public by the issuer or by or through an underwriter after such effective date whichever is later . . .; and except transactions as to securities constituting the whole or a part of an unsold allotment to or *subscription* by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

(2) Brokers' transactions, executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders." (Emphasis ours.)

In order to properly interpret 77 d, it is necessary to refer to 77 b (11), which defines the term "underwriter." It is defined as follows:

"77 b (11) The term 'underwriter' means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term issuer shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.";

Thus it is seen that the term "underwriter" is used in the Securities Act of 1933 not only in the common

parlance of the financial world, but also referring to persons regardless of their occupation who have purchased stock.

It will be remembered that no registration statement was in effect at the time of the November 18, 1954 offering circular, but the stock was offered pursuant to exemption from registration. This exemption applied only to the first sale of the stock.

Appellant purchased 5,000 shares individually under the Offering Circular and his securities firm had acquired 3,174 shares by purchase under the Circular. (R.T. p. 23, lines 10 through 21.) There is no evidence that appellant gave an investment letter or other assurance to the company at the time of his purchases under the Offering Circular. Thus no sale by appellant to the general public could be made without action of the Securities and Exchange Commission because appellant was a *statutory underwriter* under Section 77 c. That is, he purchased the shares under the Offering Circular with a view to further distribution. Distribution or sale of such shares to the general public without the safeguards set up by the Securities Act of 1933 is unlawful, voidable, and subjects appellant to loss of his license as a broker-dealer (15 U.S.C.A. 77 o (b)) and loss of his trading rights as a member of the National Association of Securities Dealers. Further, upon an attempt by appellant to sell such stock to the general public, he would be subject to injunction by the Securities and Exchange Commission.

Some of the leading cases which discuss these problems are as follows:

Securities Exchange Commission v. Mono-Kearsage Con. Min. Co., 167 F. Supp. 248 (1958)

was an action for an injunction against defendants for selling stock in a corporation. The corporation contended its delivery of stock to one Boren and his nominees was exempt under 15 U.S.C.A. 77 d (1) as a transaction by an issuer not involving any public offering. It was held that the burden of proof is upon the person claiming an exemption to show that it applies. The corporation would have reason to know, and did know, before it made the transfers in question that Boren recognized no limitations upon retransfer, that the corporation was the issuer. Boren and his associates were held to be underwriters under Section 77 b (11), in that they purchased from an issuer with a view to distribution of the stock.

Gilligan Will & Co. v. Securities and Exchange Commission, 267 Fed. (2) 461 (1959)

relates to proceedings on a petition for review of an order of the Securities and Exchange Commission suspending the membership of a registered broker-dealer partnership in the National Association of Securities Dealers for violation of the Securities Act. Petitioners were the underwriters for Crowell-Collier who acquired and distributed debentures and common stock which were not registered. Petitioners asserted that they were not statutory underwriters within the meaning of the exemption provided by the first clause

of Section 77 d (1). It was held that resales were contemplated and executed by the petitioners amounting to a distribution or public offering as defined by the Supreme Court in the *Ralston Purina* case; petitioners were found to be underwriters and the transactions were not exempt under Section 77 d (1). The Court went on to state in the *Gilligan* case that at the least, to establish entitlement to any numerical exemption in such circumstances shown there, the petitioners would have to establish a reasonable and bona fide belief that the total number involved in the placement would remain within the exemption. Otherwise, although a general public placement could be effected by a series of transfers to a small number of buyers, each distributor would be entitled to an exemption on the ground that it transferred to only a small number of buyers.

The petitioners in the *Gilligan* case also asserted that since the conversions and sales occurred more than ten months after their purchase of debentures, the Commission must find that they were held for investment. As proof of this, they cited a change of circumstances in the Crowell-Collier Company as changing their intention stated at the time of their purchase. The court held against petitioners there in language as follows:

> "We agree with the Commission that in the circumstances here presented the intention to retain the debentures only if Crowell-Collier continued to operate profitably was equivalent to a purchase with a view to distribution within the

> statutory definition of underwriters set forth in Section 77 d (1). To do otherwise would be to permit a dealer who speculatively purchases an unregistered security in the hope that the financially weak issuer had, as is stipulated here, turned the corner, to unload on the unadvised public what he later determines to be an unsound investment without the disclosures sought by the securities laws, although it is in precisely such circumstances that disclosure is most necessary and desirable. The Commission was within its discretion in finding on this stipulation that petitioners bought with a view to distribution despite ten months holding."

In *Securities and Exchange Commission v. Ralston Purina Company,* 346 U.S. 119, 73 S. Ct. 981, 97 L. Ed. 1494 (1953), the Supreme Court considered the exemptions provided by 77 d (1). It held that an issuer who claims the benefit of an exemption from 77 e for the sale of an unregistered security has the burden of proving his entitlement to it. The rationale of this result applies as well to a broker-dealer who claims the benefit of a similar exemption. Thus the burden of proof was on the petitioners to establish that they were not underwriters within the meaning of 77 d (1) (Sec. 4 (1)).

The Court in the *Ralston Purina* case also defined the standard to be applied in determining whether an issue is a public offering. It held that the governing fact is whether the persons to whom the offering is made are in such a position with respect to the issuer that they actually either have such information as a

registration would have disclosed, or have access to such information. (346 U.S. 125-127.)

The Court stated:

> "The statute would seem to apply to a 'public offering' whether to few or many . . . anything from two to infinity may serve: perhaps even one." (p. 125.)

The decision of the District Court of Appeal of California is contrary to the three Federal cases cited, in that it holds that a person in the position of petitioner could lawfully and safely sell an unregistered security to the general public without notice to, or consent of, the Securities and Exchange Commission. Petitioner, being in the business of selling securities, provided a safeguard against being forced to sell the stock, to pay the debt, unless he was assured that such a sale was lawful.

II

A COURT CANNOT REWRITE THE AGREEMENT OF THE PARTIES BY OMITTING MATERIAL LANGUAGE.

The petitioner and the said V. I. Sandell, when the agreement of April 15, 1955, was entered into as a part of the transaction when the note was executed, were both experienced in the sale and purchase of corporate stock and were familiar with the rules and regulations of the Securities and Exchange Commission of the United States.

The contract of April 15, 1955, between petitioner and respondent and executed by V. I. Sandell as

president of Sandell, Inc., a corporation, provided that "said note shall be due and payable on January 15, 1956, or as soon thereafter as clearance is granted by the SEC."

It is conceded by all parties that the clearance was necessary before the note became due and that said clearance was never obtained from the SEC. The Court held that the clearance was not necessary and in effect the Court rewrote the contract of the parties. The evidence is clear in this case that it was the intention of the parties that before the note could become due that a clearance must be had and that the clearance condition was a condition precedent to the due date of the note.

By ignoring the clearance condition the Court rewrote the agreement of the parties and in so doing deprived petitioner of his rights without due process of law.

CONCLUSION

For the foregoing reasons this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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(Appendices Follow)